

new regulatory framework sharing mechanism). If the Commission does not implement safeguards, ICG states, it could "end up with Pacific in dire financial circumstances pleading that it must have 'regulatory reform.'" (ICG Telecom Group Reply Brief, p. 12.)

Like TURN, ICG Telecom also urges the Commission to require that joint marketing of PB Com services be done by a separate staff of Pacific Bell customer service representatives to prevent discrimination in favor of PB Com. According to ICG, joint marketing then would proceed in the following manner:

"If a 'regular' Pacific Bell CSR learns that an inbound caller wishes to discuss the selection of an interLATA service provider, the CSR can: (1) provide an appropriate equal access message regarding the customer's right to choose an interLATA carrier from a randomly generated list of carriers and/or (2) process the caller's request for a particular carrier (if such a request is made by the caller, and then, and only then, if the customer has not selected an inter- and intraLATA carrier or has indicated that he/she wishes to select or learn more about the services of PB Com, (3) offer to refer the caller (on the same call...) to a 'specially trained Pacific Bell service representative' who can discuss with the caller the rates, terms and conditions of services offered by PB Com." (ICG Telecom Group Reply Brief, pp. 16-17.)

11. Position of California Cable Television

California Cable initially urged the Commission to find that the evidence in this proceeding shows that Pacific Bell and PB Com will act in concert, rather than on an arm's-length basis, to assure maximum profits for their parent company, Pacific Telesis. Because of this "symbiotic relationship," California Cable urged that dominant carrier regulation be applied to PB Com, just as it is to Pacific Bell, in order to curb potential abuses in providing equal access to other carriers, preventing misuse of CPNI, and curbing joint marketing practices that could be anticompetitive.

Following PB Com's announcement that it was willing to forgo its request for local exchange authority, California Cable states that the need for dominant regulation of PB Com "is substantially lessened." It continues, however, to urge restrictions "regarding Pacific's use of its monopoly bottleneck to misuse CPNI and ignore [the] equal access requirement." (California Cable Reply, p. 3.)

12. Position of Sprint

Sprint presented testimony recommending that PB Com's intrastate service offerings and rates be regulated under dominant carrier status, and that PB Com's purchase of carrier access services, wholesale services and unbundled elements be at terms available to PB Com's competitors. On cross-examination, Sprint acknowledged that it has plans in place to enter the California local exchange market in competition with Pacific Bell. After hearings closed, Sprint notified the Commission on January 31, 1997, that because of the FCC's recent order on Non-Accounting Safeguards, Sprint had concluded that its interests did not require submission of briefs in this proceeding.

Issues

13. Local Exchange Authority

PB Com initially sought authority to provide resold local exchange service, as well as interLATA long distance and intraLATA toll service, in order to bundle telephone services and offer customers one-stop shopping. PB Com witnesses testified that having a single telephone company for all services appeals to many consumers, and that long distance carriers, particularly MCI, already are offering one-stop shopping in certain California markets.

The FCC in its order on Non-Accounting Safeguards concluded that the Telecommunications Act does not bar an affiliate like PB Com from providing local exchange service, provided that the arm's-length requirements of § 272 of the Act are not circumvented by a transfer of access facilities to the affiliate.¹⁵ The FCC also noted that state commissions could regulate affiliates offering local and long distance service differently than they could an affiliate offering only long distance service.¹⁶

ORA, TURN and long distance companies opposed PB Com's entry into the local exchange market, arguing that such a move could mean increased income for Pacific

¹⁵ FCC Order 96-149, ¶ 309.

¹⁶ Id., ¶¶ 310, 311.

Telesis as a whole, even though it would take revenue away from Pacific Bell. TURN commented:

“Such an outcome would be in the obvious interest of the [Pacific Telesis] shareholders, but contrary to the interest of PacBell’s captive customers who likely would be asked to pay higher rates to bolster PacBell’s finances.” (TURN Opening Brief, p. 19.)

Long distance carriers also presented evidence to show that Pacific Bell already has difficulty in filling change orders for other carriers that seek to provide resold local exchange service, at one time limiting such changes to 400 a day, increasing to 2,000 per day five days a week earlier this year, as contrasted with up to 80,000 daily intraLATA changes that Pacific Bell is able to process because that procedure is more automated. AT&T witnesses said that adding PB Com orders to switch local exchange customers could further overwhelm Pacific Bell’s capacity, and could provide an opportunity for preferential treatment of Pacific Bell’s affiliate.

Much of this argument was made moot when PB Com announced in its opening brief that it was willing to forgo its request for local exchange authority because, in its view, the FCC order on Non-Accounting Safeguards permits joint marketing of PB Com services by Pacific Bell with no additional restrictions. According to PB Com, this capability obviates its need to be a competitive local exchange carrier. PB Com cautioned, however, that its withdrawal of the request for local exchange authority was premised on its not being “burdened with a host of restrictive conditions which limits its ability to compete.” (PB Com Opening Brief, p. 2.)

13.1 Discussion

An applicant for a certificate of public convenience and necessity has the burden of showing that the public interest requires that we grant the authority sought. (P.M.T. Co. (1938) 41 CRC 817.) The California Supreme Court has stated that the Commission has “the duty to consider all facts that might bear on” the public interest. (United States Steel Corp. v. Public Utilities Com. (1981) 29 Cal.3d 603, 608.)

PB Com at hearing presented no evidence of the effect on Pacific Bell (and Pacific Bell ratepayers) of PB Com competition in the local exchange arena. Every customer

switched from Pacific Bell local service to PB Com local service would mean a reduction in revenue for Pacific Bell (the difference between collecting a retail rate and a reseller wholesale rate for that customer). If history is any guide, Pacific Bell would seek to offset revenue losses through increased rates or additional charges.

Confidential Pacific Telesis documents introduced into evidence make it clear that the corporation is at least aware that PB Com could offer lower-priced packages of telephone services, including local exchange, to high-value customers, while seeking additional charges for Pacific Bell services to offset the loss of business to PB Com. Under such a scenario, Pacific Bell in effect would be subsidizing its affiliate, potentially in violation of the cross-subsidization prohibitions of the Costa Bill, PU Code § 709.2(c)(3).

The only justification PB Com offers for seeking local exchange service is its enhanced ability to provide one-stop shopping for consumers who want all of their telephone services provided by a single carrier. As PB Com's own witnesses testified, however, a customer's perception of being served by a single company essentially is achieved when Pacific Bell can jointly market its own services and those of a long distance affiliate that shares the Pacific Bell name.

PB Com states that the FCC in its Non-Accounting Safeguards order has found that the Telecommunications Act not only permits PB Com to enter the local exchange market but appears to prohibit state regulations that would prevent such entry.¹⁷ While we do not agree with the inference that this Commission is preempted in its authority to deny PB Com's application to provide local telephone service,¹⁸ it is not necessary for us to reach that jurisdictional question.

¹⁷ Id., ¶¶ 312-315.

¹⁸ The Commission, among others, has challenged an FCC order that purportedly preempts state authority over certain aspects of intrastate telephone service. See California, et al., v. FCC, et al., U.S. Court of Appeals, Eighth Circuit, No. 96-3519, et al.

We find that PB Com has in fact asked to withdraw its application for local exchange authority, and we grant that request. We reject PB Com's effort to condition its withdrawal on how the Commission deals with joint marketing matters. The Commission's jurisdiction to decide an issue that an applicant has put forward for decision cannot be conditioned on whether the applicant is satisfied with the Commission's decision.

We find further that PB Com has failed in this proceeding to meet its burden of showing that public convenience and necessity require the granting of local exchange authority. ORA and TURN, in particular, have presented evidence showing the likelihood that PB Com's entry into the local exchange market could cause substantial financial harm to Pacific Bell ratepayers, and PB Com has failed to rebut that showing. Further, PB Com has failed to show effective safeguards that it would put in place to prevent loss of revenue by Pacific Bell based on PB Com's local exchange offerings.

If such authority were to be granted in any subsequent proceeding, we would be compelled on this record to regulate such authority under dominant carrier regulation, as proposed by TURN and other parties, or to condition such authority upon our approval of the study recommended by ORA that would demonstrate that Pacific Bell's net income would not be reduced as a result of our action. The FCC has recognized the authority of individual states to impose this type of regulation or condition, or both, on affiliated companies seeking to provide integrated telephone services."

14. IntraLATA Authority

PB Com seeks authority to provide resold and facilities-based intraLATA authority. Resold intraLATA capacity would be purchased from Pacific Bell at terms available to any carrier, then marketed by PB Com in conjunction with its long distance service. With facilities-based authority, PB Com could construct its own transmission facilities to carry intraLATA traffic.

¹⁹ FCC Order 96-489, ¶ 317.

While the record shows that relatively little competition exists in the local exchange market, there are by contrast hundreds of telephone carriers in California seeking to provide long distance and intraLATA service. Our recent decision in the IntraLATA Presubscription Phase of the Alternative Regulatory Frameworks proceeding will require Pacific Bell to make intraLATA equal access (the ability to place local toll calls through another telephone carrier without having to dial additional numbers) available to competing carriers at the time that PB Com begins providing long distance service.²⁰ PB Com witnesses testified that their company must be able to bundle long distance and local toll service in order to compete effectively.

Only TURN urged initially that the Commission deny intraLATA authority to PB Com, and it acknowledged in its brief that such a ruling could conflict with the FCC's Non-Accounting Safeguards order.²¹ If the Commission grants intraLATA authority, TURN urges that such service be regulated in the same manner as Pacific Bell's intraLATA authority (with new regulatory framework price floor and price ceiling requirements) to prevent attempts to steer business to PB Com in order to evade price floor requirements.

ORA does not object to PB Com's application for intraLATA authority, but it opposes PB Com's request for facilities-based authority, expressing a concern that Pacific Telesis would construct new facilities for PB Com instead of Pacific Bell. PB Com witnesses testified that the new affiliate has no intention of constructing new facilities that would be redundant with those operated by Pacific Bell. PB Com's director of regulatory and external affairs testified that he anticipates no need for construction of intraLATA facilities in PB Com's early years of operation, but he believes such authority would be useful if conditions change.

²⁰ D.97-04-083, issued on April 23, 1997.

²¹ FCC Order 96-489, ¶ 312.

The difficulty with that, according to ORA witness Elfner, is that facilities-based authority, if granted, would not be limited. Despite what PB Com intends at this time, ORA is concerned that open-ended authority in the intraLATA market would tempt PB Com's parent company, Pacific Telesis, to divert resources from the Pacific Bell network to a PB Com network. Elfner testified:

"Under PB Com's proposal, PTG [Pacific Telesis Group] would have an incentive to devote scarce capital resources to PB Com's network, instead of PacBell's. Diversion of capital from PacBell's network to PB Com's may allow PTG to retain high value customers of PB Com, while also retaining PacBell customers that are not as likely to be lost to competitors. As a result, investment in PacBell's network may be less than otherwise, thereby affecting PacBell's service quality and slowing the introduction of new services." (Ex. C-64, p. 28.)

Elfner testified that a Telesis business plan describes new services that would be offered by PB Com, rather than Pacific Bell. If such services were facilities-based, he said, those capabilities would apparently be available only to PB Com and its customers, and not to PB Com's competitors, since PB Com is not required to make its services available for resale.

Sprint's witness Purkey raised similar concerns, recommending that PB Com be required to file for Commission approval when it seeks to construct intraLATA facilities. Such a filing, Purkey testified, would permit the Commission to monitor whether PB Com facilities were being built at the expense of improvements to the Pacific Bell system.

PB Com witness Jacobsen on rebuttal termed Sprint's proposal "entirely inappropriate." He testified:

"None of PB Com's competitors have to obtain approval before constructing each specific facility. Under the price cap form of regulation adopted in D.89-10-031, the Commission no longer pre-approves Pacific Bell's construction because its new regulatory framework/price-cap arrangement eliminates the need for pre-approval of plant additions. It makes no sense for a pre-approval process to apply to PB Com when the Commission has already abandoned it for Pacific Bell." (Ex. 2, pp. 10-11.)

Jacobsen testified that the separate operating requirements and the audit requirements imposed by the Telecommunications Act will prevent inappropriate coordination of construction by Pacific Bell and PB Com.

14.1 Discussion

PB Com has presented persuasive evidence that it can purchase intraLATA capacity from Pacific Bell (on terms available to other carriers) and package that capacity with long distance service in an offering that can enhance competition in the long distance and toll markets in California. No party except TURN opposes PB Com's entry into the intraLATA market, based on its plans for reselling such service after purchasing it from Pacific Bell.

By contrast, however, PB Com has presented no evidence of a need for facilities-based intraLATA authority, other than a vague desire to have that authority in the event that a need for intraLATA facilities develops. PB Com witnesses on cross-examination could provide no example of intraLATA facilities likely to be required in the early years of PB Com's operation.

Balanced against that showing is ORA's evidence, although for the most part speculative, that facilities authority could provide an incentive for Pacific Telesis to divert capital investment from Pacific Bell intraLATA service to PB Com intraLATA service, to the detriment of Pacific Bell and its ratepayers. Similarly, competition could be affected, in that while Pacific Bell is required to make its facilities-based intraLATA service available for purchase by other carriers, PB Com faces no such requirement.

Our order today grants PB Com's request for authority to offer resold intraLATA service. We reject the arguments of some parties that PB Com should be required to purchase intraLATA capacity only from Pacific Bell, since that would impede the ability of PB Com to compete and to seek out the most advantageous capacity agreement available in different parts of the state. Under the Telecommunications Act, intraLATA capacity that PB Com can purchase from a facilities-based carrier will also be available to PB Com's competitors.

On balance, after weighing the testimony of ORA and Sprint witnesses, among others, we have decided to deny PB Com's request for facilities-based authority for intraLATA service, without prejudice to PB Com's right to renew that request if and when a need for such authority presents itself. It is premature to grant such authority when the applicant itself sees no need for it for a period of years, especially since under the Telecommunications Act PB Com may be merged into Pacific Bell within three years.²²

We note that PB Com has complied with environmental requirements for facilities-based authority.²³ The environmental review process for facilities-based authority can be the most time-consuming aspect of a request for new facilities, and thus we do not anticipate an unreasonable delay in authorizing intraLATA facilities for PB Com if a legitimate need develops and is presented to us. By requiring that PB Com seek that authority at the time it has specific plans for facilities construction, both the Commission and other parties will have an opportunity to weigh the request based on actual construction instead of speculation of what construction might occur.

15. InterLATA Long Distance Service

The Telecommunications Act contemplates that Bell operating companies may enter the long distance market through separate subsidiaries after meeting substantial conditions. Hence, no party opposes PB Com's application to become a long distance carrier, although virtually all parties other than PB Com urge restrictions on the marketing of that service.

²² The separate subsidiary requirement for a Bell company's in-region interexchange offerings will automatically expire three years after the FCC authorizes the Bell company to provide those services, unless the FCC extends the requirement. (47 U.S.C. § 272(f)(1).)

²³ Negative declaration recommended by the Commission's Energy Division, Decision-Making Support Branch, dated January 13, 1997, on behalf of PB Com and seven other telephone carriers.

PB Com witnesses stated that their company, initially, will provide long distance service through capacity purchased from Sprint. However, PB Com also seeks facilities-based interLATA authority so that it may provide long distance service through its own switches and facilities. PB Com witnesses testified at hearing that current plans are to add relatively few facilities, limited primarily to tandem switches, until the company's share of the long distance market grows. PB Com witness Jacobsen testified that PB Com expects to have 1 million long distance customers after its first year of operation, or about 5% of California's interLATA revenues, if the company achieves its market penetration targets.

The timing of PB Com's entry into the long distance market is prescribed by the Telecommunications Act. First, the Bell company affiliate (PB Com) must obtain state certification through a proceeding like this one. Next, the Bell affiliate must obtain FCC approval to provide in-region long distance service.

The Act provides that a Bell operating company may provide in-region long distance service through a separate affiliate if the FCC finds, as one option, that the Bell operating company has entered into a state-approved interconnection agreement with a provider of exchange service.²⁴ If an interconnection agreement is in place, the FCC then must find, after consultation with this Commission, that Pacific Bell's interconnection agreements meet the requirements of a competitive checklist for unbundling, access to emergency, operator and directory services, access to telephone numbers, number portability, dialing parity, reciprocal compensation, and resale.²⁵ In California, the checklist requirements will be considered in another forum drawing participants from the Commission's Local Competition and OANAD proceedings.

²⁴ 47 U.S.C. § 271(c)(1)(A).

²⁵ Id., § 271(c)(2)(B) and § 271(d)(2)(B).

When the statutory conditions are satisfied, the FCC then must determine whether the service is broadly consistent with the public interest, consulting with the Department of Justice in doing so.²⁶ The FCC is required to make its decision on Pacific Bell's application within 90 days of the date on which the application is made.²⁷

The Telecommunications Act contains several provisions intended to protect the Bell companies during this transition period. First, interexchange carriers serving more than 5% of the nation's access lines may not jointly market resold Bell company local exchange service with their long distance service until the Bell operating company gains the right to sell long distance service in that state. Second, a state may not require intraLATA toll dialing parity until the incumbent Bell company has been authorized to offer interLATA service, or until three years after enactment of the Act.²⁸

Initially, Pacific Bell had indicated that it would seek FCC authority to provide long distance service through PB Com beginning as early as April 1997. However, the FCC application had not been filed at the time of submission of this proceeding, and it appears now that PB Com's entry into the long distance market will not take place until later in 1997.

PB Com has shown convincingly in this proceeding that its entry into the long distance market will bring increased competition in that market, and will encourage PB Com and its competitors to offer lower prices and new services to California consumers. PB Com will be a strong competitor, bringing technical expertise, a sound financial base, a recognized name, and a reputation for reliable service.

Our order today grants PB Com's application for authority to provide resold and facilities-based long distance service in California, subject to the conditions set forth in this decision.

²⁶ Id., § 271(d).

²⁷ Id., § 271(d)(3).

²⁸ Id., § 271(d)(3).

15.1 Use of Pacific Bell Facilities

The FCC in its Non-Accounting Safeguards order prohibits a Bell operating company from sharing its transmission and switching facilities with its long distance affiliate on the basis that the affiliate then could not be found to be operating independently, as required by the Telecommunications Act.²⁹ The FCC further ordered that an affiliate like PB Com could not operate, install or maintain Bell operating company transmission or switching facilities, nor call upon a Bell operating company to assist it with the facilities of other companies. Pacific Telesis, among others, is opposing these provisions of the FCC order.³⁰

On March 6, 1997, California Cable, AT&T and MCI petitioned to reopen the record in this proceeding to receive into evidence the declaration of Telesis chairman Philip J. Quigley in federal court in Washington, D.C., and to permit parties to file supplemental briefs dealing with the declaration. The Quigley declaration states that Telesis in October 1996 determined that PB Com should enter the long distance market in California primarily as a facilities-based carrier, relying on transmission and switch facilities that Pacific Bell already has in place.³¹ The petitioning parties alleged that the Quigley declaration contradicted PB Com's testimony in this proceeding.

By ALJ Ruling dated March 21, 1997, it was ruled that the Commission would take official notice of the Quigley declaration in this proceeding. Parties were permitted to file supplemental briefs on an expedited schedule. Supplemental briefs were filed on March 28, 1997, and PB Com's reply was filed on April 4, 1997.

²⁹ FCC Order 96-489, ¶ 158.

³⁰ See, Bell Atlantic Telephone Companies, et al. v. Federal Communications Commission, et al., No. 97-1067, United States Court of Appeals for the District of Columbia Circuit.

³¹ Declaration of Philip J. Quigley, Bell Atlantic Telephone Companies, supra. Pacific Bell operates an interLATA administrative network, which it is permitted to do for internal communications purposes.

The petitioning parties allege in their briefs that PB Com witnesses led the Commission and other parties to believe that PB Com would enter the long distance market primarily by reselling capacity it would purchase from Sprint. By contrast, they state, the Quigley declaration makes clear that Telesis at the time of our hearing intended to have PB Com use the facilities that Pacific Bell had installed for its own corporate long distance services. AT&T and MCI in their joint brief state:

"The fact that Pacific Bell Communications plans to provide long distance service using the facilities of its sibling local exchange monopolist clearly heightens the risk of monopoly leveraging and anticompetitive cross-subsidization. If Pacific Telesis succeeds in its plan to have Pacific Bell incur all of the network, maintenance and switching costs for the long distance services provided by Pacific Bell Communications, then the Telesis family will have a multitude of new avenues for cross-subsidizing their new subsidiary. In fact, Pacific Telesis' plan to spend 'tens of millions of dollars' to upgrade Pacific Bell's internal interLATA network to make it usable for long distance offerings of Pacific Bell Communications appears to be a virtual gift to give Pacific Bell Communications an early competitive advantage." (AT&T and MCI Joint Supplemental Brief, pp. 5-6.)

California Cable, the ICG Telecom Group and ORA filed supplemental briefs expressing similar concerns. ORA urged the Commission to audit any network expenditures by Pacific Bell on behalf of PB Com, and to require Pacific Bell to make network services available to all carriers if it later is permitted to provide such services to PB Com. Other parties stated that the contradictory positions of PB Com and Telesis further supports the recommendation that PB Com be regulated as a dominant carrier.

PB Com in its response denied any contradiction in evidence, stating that its application sought facilities-based authority for long distance service and that PB Com had explicitly reserved the right to become a facilities-based carrier through Pacific Bell or its own resources if it were permitted to do so. Initially, however, its intention, as stated at hearing, was to provide long distance service by buying Sprint capacity at wholesale rates and reselling it at retail rates.

15.1.1 Discussion

While PB Com in its testimony stated that, at some point in the future, it might purchase interLATA switch and transport services from Pacific Bell, the thrust of its testimony was that, at least initially, it planned to enter the long distance market as a reseller. PB Com presented no evidence reflecting the view of the Telesis chairman that the new affiliate would rely primarily on the interLATA transmission and switch facilities of Pacific Bell, augmented by tens of millions of dollars in investments to upgrade that system. As a result, our record is incomplete as to the anticompetitive effects, if any, of PB Com reliance on the transmission facilities of Pacific Bell.

As the ICG Telecom Group points out, the issue could be an important one in light of the Costa Bill's requirement that we find that "there is no improper cross-subsidization of intrastate interexchange service." (PU Code § 709.2(c)(3).)

On the other hand, the issue appears moot in view of the FCC's prohibition on the use by PB Com of Pacific Bell transmission and switch facilities. We tend to agree that PB Com was less than candid in discussing all of its plans for entering the long distance market. At the same time, we recognize that PB Com is dealing with uncertainty about its market entry, and that many of the plans it had developed in late 1996 were contingent on FCC orders that had not yet been issued.

We believe that ORA's recommendations strike a reasonable balance in dealing with this issue. Our order today requires that the propriety, cost and industry availability of any network services provided by Pacific Bell to PB Com be considered in an audit of PB Com. Additionally, our order prohibits PB Com from accepting network services from Pacific Bell that are not available to all telecommunications providers on a non-discriminatory basis. Presumably, these requirements will be of little moment if the current FCC prohibitions continue to apply. If the FCC prohibitions change, these requirements will help assure PB Com's compliance with the antidiscrimination provisions of the Costa Bill.

16. Joint Marketing

The FCC's order on Non-Accounting Safeguards permits a Bell operating company like Pacific Bell to market its affiliate's long distance service on all inbound calls, provided that the Bell operating company also informs new customers of their right to select the long distance carrier of their choice.³²

The FCC reasoned that the ability of Pacific Bell to market PB Com services on inbound calls from customers was part of the balance struck by Congress. The Telecommunications Act "opens local markets to competing providers by imposing new interconnection and unbundling obligations" on Pacific Bell.³³ In exchange, the Act permits Pacific Bell to provide long distance service once the competitive checklist is satisfied; but because the local market will not be immediately competitive, Congress requires that, for a period of at least three years, Pacific Bell's long distance service must be provided by a separate affiliate.³⁴ The FCC surmises that this separate affiliate requirement prevents Pacific Bell from gaining all of the economies of scope of vertical integration, with the exception that Pacific Bell can jointly market the long distance service of its affiliate.³⁵

The FCC noted that when AT&T, MCI or Sprint resell Pacific Bell's local service, they are prohibited from offering one-stop shopping until Pacific Bell's affiliate, PB Com, has in-region interLATA authority.³⁶ The FCC commented that the limitation

³² FCC Order 96-489, ¶ 292. ("Specifically, the BOCs must provide any customer who orders new local exchange service with the names and, if requested, the telephone numbers of all of the carriers offering interexchange services in its service area....As part of this requirement, a BOC must ensure that the names of the interexchange carriers are provided in random order.") (Footnotes omitted.)

³³ Id. ¶ 8.

³⁴ Id. ¶ 9.

³⁵ 41 U.S.C. § 272(g)(2) and (3).

³⁶ FCC Order 96-489, ¶ 277.

prohibiting one-stop shopping until Pacific Bell through its affiliate enters the long distance market reflects the intent of Congress to "provide parity between the Bell operating companies and other telecommunications carriers in their ability to offer 'one-stop shopping' for telecommunications services."³⁷

We are guided by the FCC's interpretation of the Telecommunications Act. Additionally, however, in authorizing the long distance authority sought by PB Com, we are governed by the mandates of the California Legislature. Specifically, in considering the matter of Pacific Bell's joint marketing of PB Com services, we are required by the Costa Bill (PU Code § 709.2(c)) to determine:

"that there is no anticompetitive behavior by the local exchange telephone corporation, including unfair use of subscriber information or unfair use of customer contacts generated by the local exchange telephone corporation's provision of local exchange telephone service," and

"that there is no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets." (PU Code § 709.2(c)(2) and (c)(3).)

A Pacific Bell witness testified that customer service representatives will make certain that new customers (defined as those seeking initial phone service or phone service at another location³⁸) are informed that they have options for long distance service, and that Pacific Bell will continue to comply with the nondiscrimination requirements of the Telecommunications Act and the Costa Bill. He and PB Com witnesses testified that joint marketing activities will be conducted fairly, and that further restrictions are unnecessary.

³⁷ Id. ¶ 277.

³⁸ "A customer orders 'new service' when the customer either receives service from the BOC for the first time, or moves to another location within the BOC's in-region territory." FCC Order 96-489, ¶ 292.

The evidence at hearing, however, shows that Pacific Bell intends to use its monopoly power in the local exchange market to maximum advantage in garnering business for PB Com. Internal Pacific Telesis documents disclosed at hearing show that Pacific Bell has many millions of incoming customer calls per year.³⁹ The evidence shows that the Telesis companies expect to attract 50% to 60% of PB Com's new customers through Pacific Bell contacts. Pacific Bell representatives will be expected to try to sell PB Com services on virtually all incoming calls, including those in which callers say that they have decided on AT&T, MCI or Sprint, for example, as their long distance carrier and simply wish to place a change order.⁴⁰

Draft marketing scripts show that Pacific Bell representatives will state that while numerous companies offer long distance service, the representative can immediately explain and sign up the caller for the long distance service offered by a Pacific Bell subsidiary. The scripts are obviously designed to focus the attention of customers on only one long distance carrier, PB Com.

Additionally, the evidence shows that Pacific Bell representatives will be expected to seek the permission of callers to use their proprietary records for the purpose of marketing PB Com services. TURN introduced a discovery response from PB Com showing two sample questions that Pacific Bell representatives may use to request customer authorization to use CPNI:

"The first question could be used in general discussions with customers:

'I'd like to talk to you about products that would be of use to you offered through PacBell Bell affiliates. May I access your records to do so?'

³⁹ The precise number, received into evidence under seal, is set forth in Ex. C-21.

⁴⁰ Evidence of specific marketing plans, much of it speculative in view of then-pending federal and state regulations, was received under seal in a number of exhibits, including Ex. C-13, C-22 and C-20.

"This second question could be used when a customer calls PacBell to establish local exchange service-

'May I refer to the information you just gave me to discuss other services offered through PacBell Bell affiliates that may help you?'

(Ex. 28; see also sealed exhibit C-14.)

Reviewing Pacific Bell's joint marketing plans, TURN witness Costa testified:

"This situation would give PacBell Com a huge advantage over its competitors. PacBell is the state's largest local exchange telephone company and serves the vast majority of customers. Under PacBell Com's plan, virtually every customer who contacted PacBell service representatives regarding any customer service question could be steered to PacBell Com. Customers desiring information about [interexchange carrier] services would be told they could only obtain information about PacBell Com services and they would have to make additional telephone calls to find out about services from other companies." (Ex. 99 at 7.)

PB Com witnesses justified the company's plans for aggressive sales efforts on incoming calls to Pacific Bell on the basis that PB Com will begin its long distance service with zero customers, and it will face entrenched and powerful competitors like AT&T, MCI and Sprint. Joint marketing of its long distance service by Pacific Bell, the witnesses said, is the single most important advantage PB Com has in gaining a foothold in the long distance market.

16.1 Discussion

The evidence in this proceeding shows, beyond peradventure, that PB Com intends to seek maximum leverage of Pacific Bell's monopoly power as the state's primary local exchange carrier in order to acquire new customers for PB Com. The overwhelming majority of telephone customers either must or because of habit will continue to call Pacific Bell first when they want to inquire about their service, add new service, order new features, change their directory listing, or request a change in long distance carriers.

Based on the internal Pacific Telesis documents presented at hearing, it is clear that Telesis, Pacific Bell and PB Com intend that virtually all of these Pacific Bell callers will automatically be the target of aggressive sales efforts on behalf of PB Com, including planned use of callers' proprietary customer information maintained in Pacific Bell files. That is, a Pacific Bell representative will ask callers if their customer records may be reviewed to better serve them, then use their calling patterns to stress advantages of PB Com service.

There can be little question that this is the type of activity proscribed by the Costa Bill. Sales efforts of this nature on behalf of PB Com to virtually all Pacific Bell callers, regardless of the reason they are calling, constitutes "unfair use of customer contacts generated by the local exchange telephone corporation's provision of local exchange telephone service." (PU Code § 709.2(c)(2).)

By the same token, use of customer proprietary information maintained by Pacific Bell to encourage the sale of PB Com services over those of competitors is the type of marketing that the Legislature must have envisioned in urging us to determine that there is "no anticompetitive behavior by the local exchange telephone corporation, including unfair use of subscriber information...." (PU Code § 709.2(c)(2).)

If more effective competition is to develop in the interLATA and intraLATA markets in California, this Commission must exercise its obligations under PU Code §§ 1001 and 709.2 to ensure that unfair and anticompetitive exploitation of inbound calls is not permitted.

We are concerned also that the joint marketing plan envisioned by PB Com and Pacific Bell can erode the equal access requirements of the Telecommunications Act and the Costa Bill. The FCC in its Non-Accounting Safeguards order requires Pacific Bell and other Bell operating companies to continue to "inform new local exchange customers of their right to select the interLATA carrier of their choice and take the customer's order for the interLATA carrier the customer selects."⁴¹ The same provision finds that this obligation is "not incompatible with" the Bell companies' right to market and sell the services of their interLATA affiliates, commenting that "a BOC may market its affiliate's interLATA services to inbound callers, provided that the BOC also informs such customers of their right to select the interLATA carrier of their choice." (FCC Order 96-489, ¶ 292.)

As TURN points out, the FCC offers no guidance on how to reconcile these business office practices that are, if not incompatible, at least in tension. The equal access requirement is an empty formalism if Pacific Bell can satisfy it by simply referring to "many choices," and then describing its affiliate's long distance service in detail. The evidence shows that this is precisely what the Pacific companies intend to do. Based on our reading of the FCC order, the FCC did not intend so artful a disregard of a Bell company's equal access obligations.

The parties propose numerous means by which this Commission might oversee and regulate Pacific Bell's joint marketing activities to prevent anticompetitive behavior proscribed by the Costa Bill. One proposal urges development of a series of pronouncements that a service representative would be required to make before selling PB Com services to Pacific Bell callers. Another proposal urges advance approval by our staff and even by competitors of scripts that Pacific Bell service representatives would be required to follow in responding to different types of consumer calls. These

⁴¹ FCC Order 96-489, ¶ 292.

proposals and others would have us monitor the utterances of Pacific Bell employees to a degree and in a manner that we find unwarranted.

Instead, we will adopt the proposal of TURN and the ICG Telecom Group, conditioning our approval of the PB Com application upon its arrangement to have Pacific Bell establish a separate group of customer service representatives to perform the joint marketing on behalf of PB Com. That is, Pacific Bell's regular customer service representative will respond to calls as he or she does now, including the equal access disclosure, the processing of change orders and the handling of day-to-day questions. After responding to a caller's inquiry, the service representative then may offer to transfer the caller, if the caller desires, to another Pacific Bell representative who can explain the long distance service offered by Pacific Bell's affiliate.

Our order today also requires that the separate staff members who will market PB Com will not have access to CPNI unless and until Pacific Bell has devised some means by which CPNI can be used on behalf of competitors of PB Com in the same manner that it is used on behalf of PB Com. Pacific Bell's regular customer service representatives would continue to have access to CPNI, as they do today, to assist callers. PB Com argues creatively that using CPNI on behalf of PB Com is permissible under FCC rules, in that Pacific Bell is not conveying such information to PB Com. While that may or may not satisfy the FCC rules, it does not overcome the Costa Bill prohibition against unfair use of subscriber information generated by the Bell company's provision of local exchange services.

We are aware that the FCC has stated its intention to address CPNI issues in a subsequent order in CC Docket No. 96-115.⁴² If that FCC order produces a method of using Pacific Bell CPNI on behalf of its long distance affiliate without the potential for preferential treatment shown on this record, PB Com or Pacific Bell may at that time propose different measures for dealing with CPNI use.

⁴² Id., ¶ 300.

We believe that the separate staff and CPNI requirements set forth here avoid potential conflict with the Costa Bill without seriously affecting Pacific Bell's ability to market its affiliate's long distance service to callers who express an interest. At the same time, the separate staff requirement accomplishes two other important objectives. First, as noted by ICG Telecom, Pacific Bell response time and service to callers will not suffer to the extent that seems likely if regular service representatives were compelled to spend extra minutes on virtually every call to explain and market PB Com services. Second, since PB Com must pay Pacific Bell for any marketing services on an arm's-length basis,⁴³ the cost of a separate staff can be calculated more accurately than PB Com had proposed. (A PB Com witness explained that there would be time-and-motion studies to estimate the number of minutes that Pacific Bell sales representatives would be devoting to PB Com sales.)

We have reviewed carefully the Non-Accounting Safeguards and the Accounting Safeguards orders issued by the FCC in Orders 96-489 and 96-490, and we believe that the joint marketing rules we adopt today are in full conformance with the FCC mandates. Indeed, the FCC was careful to point out areas in which states should continue to exercise a role in regulating interLATA affiliates. FCC 96-489 expressly recognizes that (1) the states retain ratemaking authority with respect to intrastate interLATA services (§ 30); (2) the states retain authority to enforce other obligations related to PB Com's provision of intrastate interLATA service (§ 47, fn. 97), such as those that may be imposed as a result of this certification proceeding; and (3) the states retain authority to regulate integrated affiliates (i.e., those that provide both interLATA and intraLATA services) differently from other carriers (§ 317). As the FCC notes, the fundamental objective of the Telecommunications Act "is to bring to consumers of telecommunications services in all markets the full benefits of vigorous competition." (FCC Order 96-489, § 7.) Our order today furthers that objective.

⁴³ Telecommunications Act, § 272(b)(5).

We note, finally, that the requirement for a separate joint marketing staff is likely to be short-lived. The Telecommunications Act contemplates that, in three years, the requirement that Bell operating companies conduct long distance service through a separate affiliate is to end, unless extended by the FCC. Assuming the development of competition in local exchange and other telephone services, PB Com is likely to be merged into Pacific Bell's operation, and the joint marketing restrictions adopted during this transition period may no longer be necessary.

17. Dominant Carrier Regulation

AT&T and MCI, joined by TURN, urge the Commission to require that PB Com be regulated as a dominant carrier, subject to the cost imputation, price floor and tariffing restrictions applicable to Pacific Bell and AT&T. ORA urges dominant carrier regulation if its other recommended safeguards are not adopted. The major concern of the parties is that Pacific Bell can avoid restrictions on its market power by a concerted effort with PB Com to direct high value customers to a less stringently regulated PB Com.

TURN notes that the Commission in Re Local Exchange Competition, D.96-03-020 (March 13, 1996), addressed pricing flexibility, recategorization of retail services, rules for the use of customer-specific contracts, and rules for bundling of services by incumbent local exchange carriers. According to TURN, the applicant's proposal to be treated as a nondominant carrier with respect to local service "is a transparent end run around the regulations that the Commission has found necessary to restrain PacBell's market power." (TURN Opening Brief, p. 35.)

As conceded by California Cable, however, the need for dominant carrier regulation of PB Com is substantially lessened by applicant's withdrawal of its request for local exchange authority. PB Com will take no local exchange revenue from Pacific Bell, nor does it seem likely that PB Com can be used by Pacific Telesis as a vehicle for evading local exchange rules imposed on Pacific Bell.

The record shows that while AT&T, MCI and Sprint have respectively 68%, 19% and 8% of national long distance revenue, PB Com estimates that at the end of its first full year it will have at most a 5% share of California long distance revenue. PB Com witness Jacobsen testified that if PB Com is saddled with dominant status, regulatory restraints will make it difficult to compete with other long distance carriers. For example, he testified, dominant status would mean that PB Com would have to develop cost-based price floors, with full imputation of costs, for each service it offers, submit supporting cost studies to the Commission staff, then respond to challenges by intervenors in what could be lengthy hearings. He testified that delays in price changes would make it difficult to bring lower prices and promotions to the market quickly, thus forestalling innovative pricing and products.

We conclude that PB Com's withdrawal of its request for local exchange authority removes much of the impetus for dominant carrier regulation. Like the FCC, we believe that such regulation, in these circumstances, "would not conform with the deregulatory, pro-competitive goals of the 1996 Act,"⁴⁴ and with the deregulation objectives of this Commission. As PB Com notes:

"Companies in competitive industries do not set their prices on the basis of cost of service studies, they certainly do not impute costs where none exist, and they do not give their competitors advance warning of their price changes. They price on the basis of the market, and then work very hard to ensure that their costs are below the prices which they are able to charge." (PB Com Opening Brief, p. 43.)

Because the evidence shows that PB Com cannot achieve dominant market power in the foreseeable future, and because existing regulations and the measures we adopt today curb PB Com's use of Pacific Bell's market power, we will regulate PB Com as a nondominant provider of intraLATA and interLATA services.

⁴⁴ FCC Order 96-489, ¶ 258.

18. Audit Requirements

While we decline to impose dominant carrier regulation on PB Com, we agree with ORA that additional audit requirements are desirable. The record in this proceeding is replete with evidence that PB Com and Pacific Bell, quite understandably, will cooperate to the maximum extent permitted by law in marketing PB Com's new services. The record also shows that there are opportunities, through inadvertence or otherwise, for the Telesis companies to slip over the line of permissible behavior. Indeed, a Pacific Telesis witness on cross-examination by AT&T acknowledged that there have been errors in the recording, valuation and payment by PB Com for confidential information transmitted to it by Pacific Bell. While he testified that the errors were inadvertent and would be corrected, he was compelled to agree that an audit could have identified the errors and could have permitted early correction.

Section 272(d) of the Telecommunications Act requires that a Bell affiliate like PB Com "shall obtain and pay for a joint federal/state audit every two years conducted by an independent auditor to determine whether such company has complied" with the accounting and structural safeguards required by the Act,⁴⁵ and to report the results of that audit both to the FCC and to this Commission. In its Accounting Safeguards order issued on December 24, 1996, the FCC requires formation of a joint federal/California audit team and requires that the first audit of transactions between Pacific Bell and PB Com take place one year after PB Com begins service, with similar audits every two years thereafter.⁴⁶

⁴⁵ 47 U.S.C. § 272(d)(1).

⁴⁶ FCC Order 94-490, ¶¶ 198, 203.